revenues (whether or not they once partially reflected historical costs) is an improper "rate-based" approach. **[NPRM, paras. 126-130, 144.]** The rate-based approach seeks to establish a revenue requirement for carriers, and then works backwards to derive specific rates aimed at recovering 100% of that requirement.[64] The FCC's system of price cap regulation departs from rate-base regulation only in that it permits rates and rate relationships to change without regard to costs or cost relationships. In effect, price cap regulation permits the carrier to establish its own revenue requirement within the confines of the price cap formulae, thereby divorcing the revenue requirement from either the carrier's historical or forward-looking costs. Any loading of excess revenues onto TSLRIC rates reflects a rate-based methodology which is impermissible under Section 252(d)(1).

B. The FCC Should Prohibit All TSLRIC-Plus Methodologies

[NRPM, para. 144.] Even if the ILECs could identify overheads which they would not recover through TSLRIC rates, the FCC should prohibit them from loading excess revenues onto the TSLRIC price to create a "TSLRIC-plus" rate. The FCC would compromise the utility of TSLRIC pricing by seeking to mix and

[64] The FCC has recognized on numerous occasions the flaws of the rate-based approach in combination with rate-of-return regulation. It provides an incentive for an ILEC to operate inefficiently and to overcharge for its services and facilities. E.g., Policy and Rules Concerning Rates for Dominant Carriers, 4 FCC Rcd 2873, 2889-93, 2907-13 (1989).

match backward- and forward-looking methodologies when deriving rates for interconnection or unbundled network elements. Any increase in the rate above the economic cost of providing the facility or service will depress demand artificially. Further, by deviating from cost, the ILECs would distort economic relationships between services and facilities, sending economically incorrect pricing signals to purchasers and undermining competitive conditions between carriers who compete with each other based upon the services and facilities they obtain from ILECs. The value of TSLRIC pricing is significantly compromised, if not lost altogether, by creating a hybrid "TSLRIC-plus" rate to reflect some loading of excess revenues.

Section 252(d)(1) prohibits any TSLRIC-plus methodology because a TSLRIC-plus rate is not cost-based. Professor Alfred Kahn has noted:

> "The only costs that have objective reality are ones that describe a causal relationship between the act of purchase and their incurrence. Cost allocations that are not grounded in causality have no basis in objective reality; they have no meaning independent of the prices they are supposed to justify, except in some ritualistic, incantational sense. Allocations of cost on the basis of benefit or some other conception of fairness are tautological, or teleological; they are merely a plausible devise for clothing with the appearance of cost justification some preconceived notion of what the proper price should be, rather than meaningfully independent test of the economic propriety of those prices."[65]

---

[65] A. Kahn & W. Shew, "Current Issues in Telecommunications Regulation: Pricing," 4 Yale J. on Reg. 191, 207 (1987).

The ILECs concede that inflating TSLRIC to produce additional revenues is inherently arbitrary. As BellSouth has stated, "determining the appropriate above-direct cost price level of a service is not a matter of 'cost justification' because, by definition, the particular contribution included in the price of any given service is not causally related to the cost of the service itself."[66] Because such contribution cannot be cost-justified in any economic or objective sense, TSLRIC-plus rates for interconnection or unbundled network elements would violate the statutory requirement that rates be based on economic costs.

This is not to say that the FCC needs to determine now whether the ILECs can recover any portion of their excess revenues from the carrier industry. The point is that such excess revenues should not be recovered through rates for interconnection or network elements, which must be based on economic costs. The FCC has commenced other proceedings, such as the universal service proceeding in CC Docket No. 96-45, to determine whether the ILECs are entitled to recover excess revenues and from whom. CompTel has proposed an interim plan that would permit the FCC to address those issues thoroughly without affecting its interpretation of Section 251(c) or the rules it adopts to implement the pricing requirements of Sections

---

[66] See "BellSouth Response to Application for Enforcement filed by the Competitive Telecommunications Association," filed with the Department of Justice, Dec. 2, 1994, at p. 32; id. at 33 ("allocations of indirect costs cannot be 'cost justified'").

251(c) and 252(d).[67] The 1996 Act precludes the FCC from building excess revenues of any kind into the rates for interconnection and unbundled network elements under Section 251(c).[68]

C. Price Cap Regulation Is Unlawful For Co-Carrier Arrangements Under Section 251(c)

[NPRM, para. 123.] The FCC incorrectly concludes that the 1996 Act may be consistent with price cap regulation because it is "indirectly based on costs." Instead, the FCC must prohibit the use of a price cap approach for changes in the ILECs' rates for interconnection and unbundled network elements under Section 251(c). By definition, a price cap approach permits ILECs to modify rate levels and rate relationships without regard to changes in the underlying costs or cost relationships.[69] The FCC has always recognized that compliance with the price cap formulae does not guarantee that a rate is cost-based. Parties may file formal complaints challenging such a rate as unreasonably high based upon the carrier's cost of

---

67 See Section V., infra.

68 Section 254(k) underscores Congress' desire to remove all cross-subsidies from the rates for services and facilities. That section prohibits any carrier from using services that are not competitive to subsidize services that are subject to competition.

69 The FCC requires carriers governed by price cap regulation to submit cost support for rate changes only for below-band and above-cap tariff filings. See 47 C.F.R. § 61.49(d)-(e).

providing service.[70] Therefore, giving ILECs the flexibility to revise their rates under a price cap regime would be contrary to the requirement in Section 252(d) that rates must be based on economic costs.

Further, the price cap system stems from the traditional system of carrier-initiated tariffs for services to customers pursuant to Section 203 of the Communications Act.[71] By contrast, Sections 251(c) and 252 establish a co-carrier regime whereby ILECs establish unseparated rates through negotiations with other carriers subject to review, arbitration and approval by state commissions. Under the co-carrier regime, ILECs are not entitled to change rates unilaterally as they do now through their annual access charge tariff filings. If an ILEC desires to establish a new co-carrier rate for interconnection or unbundled network elements, it must do so in compliance with the mechanisms established by the 1996 Act and the implementing rules adopted by the FCC and state commissions.

---

70 Policy and Rules Concerning Rates for Dominant Carriers, 6 FCC Rcd 2637, 2731-2734 (1991); see also id., 3 FCC Rcd 3195, 3300 n.363 (1988) (Further Notice of Proposed Rulemaking). The only complaint that would be barred by price caps is one alleging that a rate is unreasonable based on the carrier's rate of return.

71 E.g., Policy and Rules Concerning Rates for Dominant Carriers, 4 FCC Rcd 2873, 2896 (1989) (recognition that FCC has "implement[ed] price cap regulation primarily through the [Section 203] tariffing process").

D. The FCC Should Consider Establishing Benchmark Rates or Proxies As A Reliable Mechanism For Achieving Nationwide TSLRIC-Based Rates

[NPRM, paras. 134-143.] The FCC asks whether it should adopt rules establishing an outer boundary or proxies for rates in lieu of examining cost data or specifying a cost methodology. It would patently violate the express terms of Sections 251(c) and 252(d) for the FCC to use any proxies or rate ceilings which do not reflect the unseparated economic costs of interconnection or network elements. The FCC should not use proxies or rate ceilings in any way that compromises Congress' express desire for cost-based rates.

At the same time, the FCC should seriously explore the establishment of proxies or other mechanisms to facilitate the process of establishing nationwide rates for interconnection and network elements that reflect TSLRIC pricing.[72] It is imperative that TSLRIC-based prices be established as soon as possible throughout the nation. Carriers should not have to delay entering new markets just because the ILECs drag their feet on completing accurate and usable TSLRIC studies. To speed the availability of TSLRIC-based rates to carriers for interconnection and network elements under Section 251(c), the FCC should consider establishing a Federal-State Joint Board

---

72 As noted below in Section VI.E., infra, CompTel urges the FCC to consider establishing similar benchmarks for the pricing of wholesale retail service offerings mandated by Sections 251(c)(4) and 252(d)(3).

("Joint Board") mechanism to develop such rates on a nationwide basis consistent with the statutory role of state commissions in supervising and reviewing TSLRIC studies and prescribing individual rates.[73]

In particular, the FCC should consider requesting that state commissions forward to the FCC and the Joint Board any TSLRIC studies which the commissions believe to be useful in establishing TSLRIC rates for interconnection or network elements under Section 251(c).[74] After examining the TSLRIC studies submitted to it by state commissions, the Joint Board should act on or before November 8, 1996 (i.e., three months after the FCC's decision in this proceeding) to recommend nationwide benchmark rates for interconnection and network elements, and the FCC should act on that recommendation immediately. These benchmark rates would apply on a nationwide basis to co-carrier arrangements under Section 251(c), except that a state commission which has supervised or reviewed TSLRIC studies and found such studies to establish a sound basis for deriving TSLRIC-based rates can deviate from one or more benchmark rates for good cause.

When establishing a benchmark rate, the Joint Board should select a rate at the low end of the range of reasonable

---

[73] 47 U.S.C. § 410(c).

[74] In the alternative or in addition, the Joint Board and the FCC could rely upon the Hatfield Model in devising nationwide benchmark TSLRIC-based rates.

rates support by TSLRIC data. Otherwise, ILECs with TSLRIC rates lower than the benchmark rate will have obvious incentives to delay completing a meaningful TSLRIC study. Further, the FCC should clarify that the benchmark rate, as a reasonable proxy for TSLRIC rates, is not subject to volume and term discounts unless state commissions, in reliance upon TSLRIC data in their states, can show good cause that such discounts are consistent with TSLRIC pricing. By providing for the Joint Board to establish benchmark nationwide rates, the FCC would provide a necessary incentive for ILECs to conduct meaningful TSLRIC studies without unreasonable foot-dragging, and permit carriers to enter new markets sooner rather than later in fulfillment of Congress' intention to establish open, competitive markets for all intrastate and interstate services.

However, the benchmark or proxy approach cannot possibly succeed were the FCC to use existing access rates as proxies or rate ceilings on an interim or permanent basis. **[NPRM, para. 139.]** The FCC's suggestion that such rate levels are "reasonably cost based" completely ignores the industry consensus that all access rates are many times higher than the ILECs' economic costs of providing the underlying service.[75] The 1996 Act prohibits the FCC from using the inflated access rate

---

[75] "The Cost of Basic Network Elements: Theory, Modeling and Policy Implications," Hatfield Associates, Inc., March, 1996 at i (access rates approximately seven times higher than economic costs).

levels in the ILECs' current tariffs as proxies or rate ceilings for interconnection or network elements under Sections 251(c).[76]

E. The FCC Should Not Adopt or Permit Ramsey Pricing for Rates Under Section 251(c)

[NPRM, para. 130.] The FCC asks how embedded overheads could be allocated among services and facilities if the FCC decides to permit rates to be set above incremental cost levels. As noted above, the statute mandates adoption of economic-cost pricing (TSLRIC). However, if the FCC decides to permit embedded overhead loadings, it should not permit ILECs to engage in Ramsey pricing by loading overheads in inverse relationship to demand elasticity. Ramsey pricing presupposes a retail setting where such pricing does not affect underlying competitive conditions.[77] Carriers will obtain interconnection and unbundled network elements from ILECs on a co-carrier basis in an intermediate market as inputs for the services that they will provide in

---

[76] As regards transport, the record in CC Docket No. 91-213 demonstrates that the FCC's pricing rules for transport result in rate levels far in excess of economic costs, as well as distorted rate relationships among DS3, DS1 and tandem-switched routing. **[NPRM, para. 139.]** The FCC's pricing rules are currently on appeal before the U.S. Court of Appeals for the D.C. Circuit, and the FCC should not prejudge the outcome of that appeal by adopting rules which rely directly or indirectly upon the reasonableness of current transport rates. Competitive Telecommunications Ass'n v. FCC, Nos. 95-1168 & 95-1170 (D.C. Cir.).

[77] As the Commission correctly notes, Ramsey pricing also is designed for markets served by a regulated monopoly, not a market subject to open entry by new facilities-based and resale competitors. **[NPRM, para. 130.]**

competition with each other (and with the ILECs). Ramsey pricing would permit the ILECs to discriminate among purchasers of interconnection or network elements without regard to economic costs or cost relationships, thereby undermining retail competitive conditions.[78] Ramsey pricing is flatly inconsistent with the co-carrier regime under Section 251(c) and should not be permitted.

F. The FCC Should Prohibit non-TSLRIC Volume and Term Discounts under Section 251(c)

[NPRM, paras. 154, 155-156.] The FCC asks whether it should require or permit volume and term discounts for unbundled network elements under Section 251(c)(3). Once the FCC adopts the TSLRIC standard, there is no need for a separate policy on volume and term discounts. Such discounts are lawful under Sections 251(c) and 252(d) only when they are consistent with TSLRIC pricing. Similarly, ILECs should not offer volume or term discounts for interconnection under Section 251(c)(2) except to the extent such discounts are consistent with TSLRIC pricing.

---

[78] A. Kahn, The Economics of Regulation: Principles and Institutions, Vol. 1 at 172 (1970) ("selective rate reductions are suspect where they have no justification other than the fact that the favored customers happen to have competitive alternatives that other customers do not enjoy"); id. at 159 ("price discrimination raises the most serious questions when the customers being discriminated among are themselves in competition with one another").

V. THE FCC MUST ADOPT AN INTERIM PLAN FOR EXCHANGE ACCESS OBTAINED ON A STAND-ALONE BASIS UNDER SECTION 251(C)

[NPRM, paras. 132, 145.] The 1996 Act's provisions entitling carriers to obtain exchange access on a stand-alone basis for their own long distance services through co-carrier arrangements with ILECs under Section 251(c),[79] as well as the provisions requiring such arrangements to be priced based on economic costs, are a seismic event for the telecommunications industry. The FCC may be concerned about possible interim disruptions to carriers and consumers during the time it will take to implement the new co-carrier regime fully. Certainly, the ILECs will recover fewer exchange access revenues from co-carrier arrangements at TSLRIC rates than they recover today from their inflated carrier-to-customer access charges, which might fuel concerns that the ILECs would seek to compensate themselves through higher local rates. While CompTel does not believe that the 1996 Act will lead to higher net local rates for consumers,[80] we believe it is essential to remove that concern in its entirety

[79] As CompTel demonstrated above in Section III., supra, carriers are entitled to obtain exchange access on a stand-alone basis for their own long distance services through co-carrier interconnection arrangements under Section 251(c)(2) and/or through the purchase of the features and functions, individually or in aggregations, that comprise exchange access pursuant to Section 251(c)(3).

[80] To the contrary, CompTel believes that the onset of full-service competition through the purchase of unbundled network elements at TSLRIC rates under Section 251(c)(3) and through the purchase of local exchange service at true wholesale rates under Section 251(c)(4) will lead to more choices and lower rates for local consumers.

to ensure that the FCC's interpretation of the 1996 Act, and its adoption of rules to implement the Act, are not influenced in any manner whatsoever by fears of local rate hikes. The 1996 Act will preside over the telecommunications industry for decades to come; the FCC's interpretation and implementation of the Act at this critical juncture should not be driven by concerns about interim side-effects during the transition to the co-carrier regime.

CompTel proposes the following plan for the interim pricing of exchange access obtained on a stand-alone basis through co-carrier arrangements with ILECs pursuant to Sections 251(c)(2) and (c)(3).[81] This plan is contingent upon the FCC's interpretation of Sections 251(c) and 252(d) to entitle carriers to obtain exchange access for their own long distance services at rates based on economic costs, and upon the FCC's adoption of TSLRIC pricing (without any overhead loadings reflecting embedded or historic costs) as a uniform national standard for such arrangements. For an interim period ending when the FCC completes the universal service proceeding as required by Section

---

[81] Although this plan would apply to exchange access obtained on a stand-alone basis through the purchase of features and functions, on an individual or aggregated basis, pursuant to Section 251(c)(3), it would not apply to situations where the carrier, through the purchase of network elements under Section 251(c)(3), replaces the ILEC as the end-user subscriber's local exchange carrier for purposes of providing telephone exchange service and exchange access. <u>See</u> <u>infra</u>, this section.

254(a)(2),[82] CompTel proposes that the FCC grant a blanket waiver of TSLRIC pricing for exchange access pursuant to its implementation authority under Section 251(d) and its traditional statutory authority to waive its regulations for good cause. During that time, the ILECs would continue to provide exchange access, as they do today, pursuant to their intrastate and interstate carrier-to-customer access charge tariffs. Under this plan, the ILECs would not lose exchange access revenues from the flash-cut migration of stand-alone exchange access traffic to the new co-carrier regime, thereby quelling any fears, whether justified or not, that the ILECs would seek to compensate for lost exchange access revenues through higher local rates.

During the interim period, the FCC should move forward in the universal service proceeding in CC Docket No. 96-45, and through further proceedings in this docket, to identify lost revenues from the TSLRIC pricing of exchange access obtained on a stand-alone basis under Section 251(c).[83] The FCC should then decide whether the ILECs are entitled to recover any portion of those revenues from carriers and, if so, devise appropriate mechanisms for doing so. In CompTel's view, the evidence will

---

[82] The FCC must complete that proceeding by May, 1997, although it should make every effort to do so earlier than that if possible.

[83] This aspect of the interim plan is consistent with the FCC's expressed intention of "conduct[ing] and conclud[ing] all of these proceedings in a comprehensive, consistent and expedited fashion." **[NPRM, para. 3.]**

compel the FCC to conclude that the ILECs are not entitled to any additional compensation from carriers beyond TSLRIC rates other than the recovery of limited universal service subsidies, and that ILECs should seek to offset lost revenues through more efficient operation and new services. The 1996 Act is flatly inconsistent with guaranteed revenue streams for any carrier or other industry participant. However, that is not an issue that needs to be decided now, and it certainly should not affect the FCC's interpretation and implementation of the core provisions of the 1996 Act. By preserving the status quo for exchange access until those issues are fully considered and resolved, this plan would ensure that the 1996 Act does not cause any unnecessary short-term disruption to carriers or consumers.

If the FCC accepts this plan, it would need to act in two separate proceedings to obtain the data necessary to determine whether and how the ILECs should recover lost exchange access revenues. First, the FCC should complete its universal service proceeding and identify the costs for which ILECs and other qualified carriers should receive reimbursement from the industry. Second, the FCC should identify the lost exchange access revenues due to the TSLRIC pricing of exchange access obtained on a stand-alone basis pursuant to Sections 251(c)(2) and (c)(3). In order to identify those revenues, the FCC should require ILECs to submit reports regarding the TSLRIC rates for exchange access, as well as demand data and other relevant information on a state-by-state basis. These data would permit the FCC to identify the exchange access revenues which the ILECs will lose through the TSLRIC pricing of stand-alone exchange access arrangements under Section 251(c) and which they will not otherwise recover through universal service subsidies. If the FCC determines that the ILECs are entitled to any portion of those revenues (and CompTel submits that they are not), the FCC could develop appropriate mechanisms for recovery of such revenues from the industry wholly beyond the TSLRIC rates mandated by Section 251(c). At that point, the FCC would order the immediate transition to TSLRIC rates for stand-alone exchange access obtained pursuant to co-carrier arrangements with ILECs under Sections 251(c)(2) and (c)(3).

In the event the FCC adopts this plan or another, similar plan, the FCC should clarify that the Bell Companies do not qualify to enter the in-region interLATA market until they provide exchange access at TSLRIC rates pursuant to co-carrier arrangements under Section 251(c). Section 271(c)(2)(B)(i) requires the Bell Companies to provide "[i]nterconnection in accordance with the requirements of sections 251(c)(2) and 252(d)(1)," which, by their terms, entitles carriers to obtain exchange access for their own long distance services at prices based on economic costs.[84] The FCC should state clearly that its decision to waive the requirement of TSLRIC pricing for an interim period in no way modifies the underlying statutory

---

[84] 47 U.S.C. §§ 251(c)(2) and 252(1).

requirements. A Bell Company would be free to introduce TSLRIC pricing for exchange access under Section 251(c) at any time as part of a showing that it has satisfied the statutory preconditions for in-region entry. The FCC should not permit the Bell Companies to enter the in-region interLATA market until they have introduced cost-based prices for exchange access.

The Commission should clarify that the interim plan is appropriate only for stand-alone exchange access obtained pursuant to Sections 251(c)(2) and (c)(3), not to situations where a competing carrier replaces the ILEC as the end-user subscriber's local exchange carrier through the purchase of unbundled network elements under Section 251(c)(3). In that case, the carrier has effectively replaced the ILEC as the subscriber's local exchange carrier for purposes of providing all local services, including telephone exchange service as well as originating and terminating exchange access.[85] In situations where new entrants have successfully competed against the ILEC to obtain customers, it would contravene the language and purpose of the 1996 Act were ILECs to continue to impose access charges, even on an interim basis.[86] Further, because the development and

---

85 For a more thorough discussion of the ramifications of a carrier's purchase of network facilities through unbundled elements under Section 251(c)(3), see Section II.I., <u>supra</u>.

86 As the FCC has recognized, a carrier who purchases network elements may be able to "take market share from the incumbent if the new entrant is more efficient or if the incumbent attempts to charge prices above competitive

Continued on following page

tariffing of unbundled network elements will occur over a period of time, and carriers likely will not be able to combine network elements into their own service offerings immediately or in all geographic regions at the same time, it is likely that the ILECs' loss of exchange access revenues to carriers serving local customers through unbundled network elements will occur only gradually over time, not on a flash-cut basis. Therefore, the FCC must exclude the provision of exchange access through unbundled network elements under Section 251(c)(3) from any interim or transitional plan.

The FCC has ample statutory authority to adopt the interim plan proposed by CompTel. Section 251(d) gives the FCC plenary authority to "complete all actions necessary to establish regulations to implement the requirements of this section." Such rulemaking authority encompasses the establishment of an interim regime of limited duration to ensure a smooth transition from the current system to an entirely new regulatory model and market structure. Given the scope and complexity of the changes it has mandated for the industry, Congress did not require the FCC to implement those changes on a flash-cut basis on August 8, 1996. Further, the FCC has traditionally possessed authority under the Communications Act of 1934 to waive its rules for good cause.[87]

Continued from previous page

levels." **[NPRM, para. 76.]** There is no reason to protect ILECs from such competition.

87 See, e.g. Ameritech Operating Companies' Petition for Waiver of Part 69 of the Commission's Rules to Establish Unbundled of Part 69 of the Commission's Rules to Establish Unbundled

Continued on following page

VI. THE FCC SHOULD ADOPT THE RULES NECESSARY TO ENSURE THAT CARRIERS CAN OBTAIN LOCAL EXCHANGE SERVICE AT MEANINGFUL WHOLESALE RATES WITHOUT RESTRICTIONS

A. Meaningful Wholesale Local Exchange Rates Are Essential For A Competitive Full-Service Market

[NPRM, paras. 178-188.] Local entry through the purchase of local exchange service from ILECs at true wholesale rates without unreasonable restrictions under Section 251(c)(4) will be crucial over the near term and important on a permanent basis as well. Although purchasing network facilities in unbundled elements under Section 251(c)(3) may be a more robust form of local entry, it will take time to implement and will not occur evenly across geographic areas. In the near term, all carriers who seek to enter the full-service market will depend critically upon their ability to purchase local exchange services from ILECs at wholesale rates.

Section 251(c)(4) also affords an important mechanism for local entry on a permanent basis. Long distance carriers serve a customer base that is geographically dispersed. In locations where a carrier serves only a few customers with

---

Continued from previous page

Rate Element for SS7 Signaling, Order, 1996 WL 137968 (March 27, 1996). Section 1.3 of the Commission's rules, 47 C.F.R. § 1.3, permits the Commission to waive its own rules for good cause shown. Further, Section 4(i) of the Communications Act, 47 U.S.C. § 154(i), grants the Commission authority to perform "any and all acts" necessary in the execution of its function. This authority clearly extends to a waiver by the Commission of its own rules.

limited traffic volumes, it may be years, if ever, before it becomes economical to serve those customers through the purchase of network elements or a carrier's own network infrastructure. Further, some carriers, particularly smaller companies, may deem it unwise or infeasible to enter the local market through the purchase of network elements or the build-out of their own facilities. Those carriers will depend critically upon Section 251(c)(4) to provide local services to end-user subscribers in competition with other full-service providers. The full-service market will not be fully competitive unless the FCC adopts the minimum rules necessary to make Section 251(c)(4) a viable option for providing local services efficiently.

The FCC should not lose sight of the fact that Sections 251(c)(3) and (c)(4) provide fundamentally different vehicles for entering the local market to compete against other full-service providers.[88] **[NPRM, para. 85.]** A carrier who purchases local network facilities as unbundled elements under Section 251(c)(3) is effectively replacing the ILEC as the end-user subscriber's local exchange carrier.[89] That carrier designs its own local and

---

[88] Carriers who wish to obtain exchange access on a stand-alone basis without entering the local market are entitled to enter into co-carrier interconnection agreements with ILECs for that purpose under Section 251(c)(2). Such carriers also may obtain exchange access on a stand-alone basis through the purchase of the features and functions comprising exchange access under Section 251(c)(3).

[89] For a more thorough discussion of the ramifications of Section 251(c)(3), see Section II.I., <u>supra</u>.

other services using unbundled elements, and it is responsible for the provision of telephone exchange service and exchange access to the subscriber. By contrast, the carrier who obtains local exchange service on a wholesale basis under Section 251(c)(4) is replacing the ILEC only as the subscriber's provider of local exchange services; the ILEC will continue to be responsible for providing exchange access to the subscriber.[90] Further, the carrier is not free to design its own local services, as it simply resells the retail services offered by the ILEC, and its cost structure is more constrained because the wholesale rate is derived from the ILEC's retail pricing decisions.

We believe that virtually all carriers who wish to enter the local market will to do so in part through the resale of the ILECs' existing local exchange services under Section 251(c)(4). Many carriers also will seek to enter the local market by purchasing network facilities as unbundled elements and then combining those elements into their own local services under Section 251(c)(3). As carriers use each option over the near term and on a permanent basis, they will develop their own unique mix of the two options that best meets their own needs and requirements.[91] Therefore, the FCC must adopt the minimum rules

---

[90] **NPRM, para. 186** ("an entrant that merely resells a bundled retail service purchased at wholesale rates would not receive the access revenues").

[91] **NPRM, para. 9** ("[d]ifferent entrants may be expected to pursue different strategies that reflect their competitive

Continued on following page

necessary to develop each option for entering the local market -- Sections 251(c)(3) and (c)(4) -- to its fullest potential.

B. Local Entry Through Local Exchange Resale <u>Will Promote Efficient Facilities-Based Entry</u>

[NPRM, paras. 172-188.] Some parties argue that there is a conflict between local exchange resale under Section 251(c)(4) and Congress' desire to promote facilities-based local entry. Those parties believe that if the wholesale rate is attractive, carriers will be content to resell the ILECs' local exchange services rather than construct their own facilities as Congress intended. The FCC should reject that argument because it misreads Congress' intent and ignores several decades of FCC precedent and experience.

In adopting the 1996 Act, Congress did not intend to promote "facilities-based" local entry by all carriers in every market segment regardless of cost. Rather, Congress intended to promote efficient entry into all telecommunications markets.[92] As the FCC stated, "[b]y freeing new entrants from having to build

---

Continued from previous page

advantages in the markets they seek to target"); **NPRM, para. 16** ("the statutory scheme . . . . enables entrants to use interconnection, unbundled elements and/or resale in the manner that the entrant determines will advance its entry strategy most effectively").

92 <u>See</u> **NPRM at para. 12** (purpose of Congress "not to ensure that entry shall take place irrespective of costs, but to remove . . . economic impediments that inefficiently retard entry, and to allow entry to take place wherever it can occur efficiently").

facilities that totally duplicate the LEC's networks, the 1996 Act has dramatically increased the opportunities for competitive entry." **[NPRM, para. 8.]** Congress sought to create numerous avenues for efficient entry into the local market, including local exchange resale. Congress did not seek to predict or prejudge which entry option would prove to be the most viable economically. Rather, it created numerous tools for entering markets and left the choice of those tools to carriers governed by marketplace forces. Congress did not intend to encourage facilities-based entry in circumstances where it is economically inefficient, and the FCC should not inflate local exchange wholesale rates in a misguided attempt to make facilities-based entry comparatively more attractive.

The FCC correctly recognizes in the NPRM that facilities-based entry is promoted by, not inconsistent with, resale opportunities.[93] Historically, resale has been a way for new carriers to enter the telecommunications market without having to incur the substantial, and in some cases prohibitive, expense of building their own networks before they provide

---

[93] E.g., **NPRM at para. 10** (recognizing that "[e]ven if an entrant planned to construct its own facilities, it may still face marketing disadvantages, because of the time it takes to construct a new network" and that "[r]esale enables new entrants to offer at the outset a conventional service to all customers currently served by an incumbent LEC"); see also Interconnection and Resale Obligations Pertaining to Commercial Mobile Radio Services, 10 FCC Rcd 10666, 10708 (1995) (recognizing that resale helps mitigate head-start advantage by facilities-based carriers).

service to the first customer. Through resale, a new entrant can begin to provide services, establish a customer base, create a stream of revenues, establish its credit-worthiness, develop name recognition through marketing, and otherwise enter the market before it incurs the costs of building its own network. Once a carrier has successfully entered the market as a reseller, it can more easily make the transition to providing service through other means, including facilities construction or the use of unbundled network elements. It can raise capital to fund building out its own network, and its customer base and traffic volume will permit it to realize economies of scale and scope in doing so. Based on the customer information and marketing experience it acquires as a reseller, the carrier can decide where to operate most efficiently as a facilities-based carrier, and where to operate most efficiently as a reseller. Without efficient resale opportunities, many carriers would never be in a position to become facilities-based carriers at all.

Traditionally, the FCC has been one of the strongest supporters of efficient resale entry, and its pro-resale policy over several decades has been one of the most successful policies in the agency's history. For several decades, the FCC has vigorously enforced a policy prohibiting facilities-based domestic carriers from imposing restrictions upon the resale and sharing of their services.[94] Taking advantage of that policy,

[94] E.g., Resale and Shared Use of Common Carrier Services, 60 FCC 2d 588 (1977). The FCC continues to enforce its pro-

Continued on following page

hundreds of carriers entered the long distance market beginning in the 1970s. There are numerous examples of companies (e.g., MCI and WorldCom) who first entered the market, in whole or in part, as resellers before establishing regional or nationwide facilities-based operations. The FCC's policy should be to ensure that all market participants, including resellers, have efficient incentives to provide services, purchase network elements, or build their own networks.

C. The FCC Should Adopt Rules Requiring ILECs To Remove All Retail Costs From Their Wholesale Rates

[NPRM, paras. 172-188.] Section 251(c)(4) requires the ILECs to offer their retail local exchange services to requesting carriers at "wholesale rates," which Congress defines in Section 252(d)(3) to be the retail price minus the "marketing, billing, collection, and other costs that will be avoided by the local exchange carrier." The FCC should interpret those provisions, according to their language, to require the ILECs to develop wholesale rates which do not reflect any retail costs, that is, costs which are either directly or indirectly incurred due to the ILECs' retail operations. When a competing carrier resells an ILEC's local exchange service to an end-user subscriber, the ILEC loses a retail customer (the end user) and gains a wholesale

---

Continued from previous page

resale policy. E.g., AT&T Communications Apparent Liability for Forfeiture and Order to Show Cause, 10 FCC Rcd 1664 (1995).

customer (the competing carrier). Whatever retail costs the ILEC incurs must be recovered from its retail customers, not its wholesale carrier customers.

The ILECs would interpret Section 252(d)(3) to include only those aggregate costs which the ILECs will no longer incur at either the retail or the wholesale level. That interpretation cannot withstand scrutiny. The relevant question is, from a customer-specific perspective, what costs will the ILECs avoid in providing wholesale service to the carrier-customer rather than retail service to the end-user customer. As Section 252(d)(3) notes, those avoided costs are the "marketing, billing, collection and other costs" that the ILECs incur to provide <u>retail</u> services. Limiting the category of avoided costs to those aggregate retail and wholesale costs which the ILECs no longer incur would lead to ridiculous results. As the ILECs re-double their marketing efforts to win back the end-user subscribers who have migrated to competing carriers, the ILECs could, under their interpretation of this provision, actually impose the costs of those efforts upon the competing carriers who have just won the subscribers' business. Indeed, if the onset of local competition leads an ILEC to expand its overall advertising and marketing expenditures for its retail service offerings, the ILEC conceivably could argue that there are negative avoided costs which require the wholesale rate to be higher than the retail rate. Those nonsensical results repudiate the ILECs' interpretation of Section 252(d)(3).